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## HOME OWNERS' LOAN ACT OF 1933

By SENATOR IRA L. QUIAT

ON June 13, 1933, the Home Owners' Loan Act of 1933 became effective and the United States Government found itself about to engage in the home mortgage business.

This act is purely a relief measure. The Government does not intend to enter into competition with building and loan associations, banks, mortgage companies or with parties who have been and still are making secured loans on homes.

With the crash of 1929 and the resulting depression thereafter the earning power of the home owner was materially reduced and in some cases entirely destroyed, consequently payments to banks, building and loan associations, mortgage companies and other loan agencies were greatly reduced and these companies began to find themselves in difficulties.

A mortgage on a home is not a liquid asset, therefore foreclosures of homes necessarily followed and gradually increased until a tremendous percentage of the home owners in this country were actually being foreclosed and were being put out of their homes. Banks began to fail, building and loan associations were thrown into the hands of receivers and this aggravated the situation. A bank being liquidated could grant no extension to mortgages that became due. The receiver of a building and loan association demanded payment of the mortgage because the assets of the distressed institution had to be turned into cash as soon as possible. To relieve this condition Congress enacted the Home Owners' Loan Act solely with the idea of saving and aiding its distressed citizens whose homes had been or were about to be foreclosed, and the purpose of this law and the powers granted to the Home Loan Corporation are limited to relieving home owners who **within** the last two years have lost or who are in danger of losing their homes under foreclosure of a mortgage or lien which was of record at the time this law went into effect on June 13, 1933. The Government created a corpora-

tion styling it the "Home Owners' Loan Corporation." There were objections to the Government itself directly going into this venture, such as that the United States can not be sued, the business of lending money is not a governmental function, and other objections which I need not detail here. Therefore the Government by law established this corporation.

The law expressly states that this corporation shall be an instrumentality of the United States. It is a branch of the Government. Actually, it is the United States itself that is running this business. There is no person, no private corporation, no bank, no building and loan association, or any private party in any way interested in this corporation. The Government is the sole stockholder, having purchased two hundred million dollars' worth of its stock, the entire capitalization being authorized by law.

The directors of the Home Owners' Loan Corporation are the same men who are designated by law to be the board in charge of the Federal Home Loan Bank. In addition to the two hundred million in cash subscribed by the Government, the corporation is empowered to issue two billion dollars worth of bonds, which bonds I will discuss later.

The question naturally presents itself: What does the word "home" mean in this act, and the answer is, it means just exactly what the word "home" means in its usual and ordinary sense. The residence, the building or structure which the citizen owns and occupies as a domicile. Its use need not be entirely confined to the purposes of a residence. An incidental use will not destroy the home feature. It may have a little store or some other vocational use. The fact that there is some acreage included, used for gardening or other similar purpose, does not destroy its status as a home, but a residence situated on 160 acres is not a home, for the main purpose of the premises is farming, and therefore in such case, application for relief should be made to the Farm Loan Bank, and not to the Home Owners' Loan Corporation.

A place is still a home even though it is occupied by more than one family, but it must not accommodate more than four families. In other words, an apartment house or terrace having more than four apartments is not within the purview of the law and the corporation can do nothing to relieve under such circumstances.

The corporation is empowered to make loans which are divided into three classifications.

The first class is the kind of loan where bonds are used in payment of, or in exchange for, a mortgage. The mortgage must not exceed 80% of the present value of the home. The present value will be determined by appraisers. The corporation will employ competent appraisers who will carefully examine and determine the present valuation of the home. The valuation will not be determined by the present sluggish conditions of the real estate market. The corporation intends to be liberal, but must be safe. It realizes that at the present time it is difficult, if not almost impossible, to sell the average home. It will attempt to determine present day values; it will take into consideration the high values of 1927, 1928 and 1929 and make a reasonable reduction thereon for the depreciation in values which have occurred. It will compute the present replacement cost. It will calculate the value of the premises, based on a reasonable rental value of the property. From these three figures an average will be determined and that probably will be the appraised value.

We will assume that you own a home which is worth ten thousand dollars at the present appraisal. There is a mortgage on it not to exceed eight thousand dollars—it can not be more than 80% of the appraised value. The corporation will exchange \$8,000 of its bonds for the \$8,000 mortgage, unless the mortgagee is willing to accept less than the \$8,000, then of course the Government would pay less, and the home owner would get the credit. The old mortgage will then be extended or a new mortgage executed.

All of the mortgages to the corporation, whether in this classification or not, require monthly payments which will discharge and pay off the mortgage within fifteen years. The privilege is given to make any payment at any time, and interest is only charged on unpaid balances. In exceptional cases the corporation will permit the payments to be made quarterly, semi-annually or annually, but it prefers that the payments of principal and interest be made monthly. The amount of the payment will be the computed sum which will, within fifteen years, amortize principal and interest. For instance, under this class of loan, \$7.91 per month will, within fifteen years, pay off a principal sum of \$1,000 and the interest thereon. The payments will first be applied to the interest due and the balance will be credited on principal. The interest which this kind of a loan will bear will be 5% per annum. If, at the time of making the loan it appears that there are unpaid taxes or assessments, the corporation is authorized to advance the necessary sum or sums to pay off such taxes, and to also advance such sums as may be needed for necessary maintenance and necessary repairs, which sums so advanced will be included as a part of the mortgage, provided the total amount does not exceed 80% of the appraised value of the property.

Under the terms of the note and mortgage the mortgagor need not make any payments on account of principal during the first three years. The appraised valuation of the home must not exceed twenty thousand dollars and in no case can the amount of the new Government loan exceed \$14,000.

The second kind of loan that this corporation is empowered to make, is where the property is clear and there is no mortgage against it, but there are unpaid taxes or assessments or necessary maintenance or necessary repairs required. To take care of any one or more of these items the corporation will loan upon such home not to exceed 50% of its appraised value. The loan is to be paid back within fifteen years in the same manner as the first kind of loan and the interest is also 5% per annum. It must be borne in mind that the corporation will not make new loans on unincumbered property for any other purpose. It may be vital to purchase a new car or

to pay doctor bills or other indebtedness, but this corporation has not the power to loan money for such purposes.

By the term "necessary maintenance and necessary repairs" is meant expenses which are necessary to preserve and maintain the property. No funds will be loaned to build a new addition or for betterment of the premises. The money must be used for "repairs."

The third kind of loan that this corporation is authorized to make is where a home owner is threatened with foreclosure and the mortgagee will not accept bonds. In such event it is the duty of the local representatives of the corporation to endeavor to obtain a new loan from some private party. If this cannot be done the corporation is empowered to advance the necessary cash to take up such mortgage provided the total amount of the advancement by the corporation, for the mortgage and for repairs and for taxes and assessments does not exceed the total of 40% of the appraised valuation of such home. In other words, if the \$10,000 home has a mortgage in excess of \$4,000, nothing can be done by this corporation to relieve the home owner. If, however, the corporation is not required to make an outlay in cash of more than \$4,000, it may make such a loan. The distinct feature of this loan, however, is that it cannot be made by the local representatives of the corporation. It must be submitted to Washington and approved there. This class of loan is also payable in fifteen years in the same manner and method as the other loans with this exception, that the interest will be 6% per annum instead of 5%.

We next come to the bonds which are to be issued, a great deal of doubt concerning which exists in the minds of the public due to inaccurate statements scattered broadcast. In my opinion there is no reason why mortgagees should not accept these bonds without question, and I believe that within a year or two these bonds actually will be selling above par. Under the provisions of the law the bonds are to be payable within eighteen years. They are to bear interest at the rate of 4% per annum. The United States has guaranteed the interest on the bonds, but not the principal. Instead of this guarantee as to interest being considered as an asset, a great many people seem to single out the guarantee as to interest as

a cloud on the likelihood of the principal being paid. The fallacy of such reasoning is manifest when the purpose of this guarantee is known. Why did the Government guarantee the interest? Because this is a relief measure. No payments are required on principal during the first three years. The corporation is even empowered to extend the time of payment of interest in exceptional cases. It is therefore probable that the corporation will not realize sufficient money during the first three years to pay all of the interest on these bonds, especially when the fact is taken into consideration that the corporation will immediately start to set up sinking funds to take care of the various requirements and to meet the principal of the bonds when they become due. It is apparent that there will be a shortage of funds in the hands of the corporation during the first three years to pay interest. The United States Government therefore said: "I will guarantee you that the interest will be paid."

Had this guarantee never been made, the bonds of this corporation would be considered like the bonds of any other corporation or political entity and the value of the bonds would be determined by what was back of them.

We will assume a new improvement district is created in the City and County of Denver. Bonds are issued to pave the streets, to install sewers or for some other public betterment. Does the city guarantee the bonds of such improvement district? It does not, yet these bonds are sold at par and above par without a question and without a doubt, because the assessed valuation of the district is sufficient to insure the payment. In buying bonds of such district, the investor looks to the value of the assets in back of these bonds.

The same test should be applied in determining the value and safeness of the investment in the bonds of the Home Owners' Loan Corporation.

What is in back of the Home Loan Corporation? First, two hundred million in cash, subscribed by the Government. The Government is merely a stockholder and the bonds are therefore superior to the Government's rights as a stockholder. This two hundred million dollars will be earning interest at 5% and 6% per annum. The corporation will also be mak-

ing 1 % profit on the bonds that it has issued, for the mortgages bear interest at 5 % and the bonds only pay 4 %.

There is no question that the two hundred million dollars, and the ten to twelve million dollars which it will earn annually, the two billion dollars worth of mortgages taken for bonds, and the twenty million dollars which the Government will yearly earn on them, will furnish ample funds and assets to discharge and pay every bond in full. Another thing which will help establish the value of the bonds and keep them at par or close to par is the fact that under the law these bonds may be used and will be accepted by the corporation, at par, in payment of any mortgage or part thereof which the corporation holds.

I do not predict that these bonds will sell at par at once. Liberty bonds, if you will recall, dropped as low as 87 and 88. It is natural to expect that there will be a deliberate attempt on the part of certain financial cliques and groups to force the price of these bonds down so that they may be purchased at a discount and after they have all the bonds they desire, the price will naturally go up until it reaches par and perhaps a figure above par. The bondholder should not be anxious to dispose of his bonds at once.

Under the terms of the Glass-Steagall bill, the Federal Reserve banks may purchase and hold the Home Loan bonds without any restriction and may accept them by way of discount to the same extent as it is permitted to handle Liberty bonds, the Federal Farm Loan bonds and the other bonds of Government instrumentalities.

I have pointed out heretofore that a distressed bank or a building and loan association sometimes has difficulty in converting into liquidated assets their real estate mortgages. No such difficulty will be presented if they exchange those mortgages for bonds.

There are other provisions in the act such as the creation of Federal Savings and Loan Associations, but I will not discuss them here, for the sole object of this talk was to bring to you the picture of the powers and activities of the Home Loan Corporation insofar as it is empowered to relieve and help the distressed home owner in refinancing the mortgage on his home.